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SUPREME COURT OF THE UNITED STATES

No. 23.—October Term, 1959.

United States of America, Petitioner, *v.* Durham Lumber Company, and George H. Carter, Jr.	On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

[June 20, 1960.]

Mr. Chief Justice Warren delivered the opinion of the Court.

This case involves the competing claims of the Federal Government and certain subcontractors to a sum of money owed to the taxpayers under a general construction contract.

The taxpayers, Michael & Embree, were general contractors doing business at Durham, North Carolina. Early in 1954, they agreed to construct certain buildings for persons herein referred to as the "owners." This work was completed on July 15, 1954, but because the owners disputed the amount due under the contract, payment to the taxpayers was delayed.

In completing the construction work, the taxpayers had utilized the services and materials of numerous subcontractors, most of whom had not been compensated. The respondents are two such subcontractors, who in January and February 1955, gave the owners notice of their respective claims against the taxpayers.

On January 18, 1955, the taxpayers were adjudicated bankrupts. At that time, there was an unpaid balance of $5,250 due from the owners under the construction contract. After extensive negotiations between the owners, the trustee in bankruptcy, and the subcontractors, it was agreed that the owners would absolve themselves

from further liability by paying the $5,250 to the trustee, and that the subcontractors could thereafter assert the same rights against the trustee as they could have asserted against the owner. This arrangement was approved by both the Superior Court for Durham County, North Carolina, and the federal bankruptcy court.

Another claimant of the money deposited with the trustee was the Federal Government, which on August 13, 1954, and November 22, 1954, had assessed the taxpayers for uncollected withholding and unemployment insurance taxes. By virtue of Sections 6321 [1] and 6322 [2] of the Internal Revenue Code of 1954, a federal tax lien attached to all "the property and rights to property" belonging to the taxpayers at the time the assessments were made. The Government contended that the money owing under the construction contract was property of the taxpayers to which the tax lien attached.

The Referee in bankruptcy, attempting to resolve the competing claims against the fund as if the parties were before a state court, decided that the rights of the Federal Government under its tax lien were superior to those of the respondents. The District Court for the Middle District of North Carolina disagreed, and held that the respondents were entitled to payment of their claims before the Government could satisfy its tax lien. On appeal, the

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[1] Section 6321. Lien for taxes:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

[2] Section 6322. Period of lien:

"Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time."

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Court of Appeals for the Fourth Circuit affirmed, 257 F. 2d 570. We granted certiorari. 359 U. S. 905.

In affirming the judgment of the District Court, the Court of Appeals stated that the nature and extent of the general contractors' property rights, to which the tax lien attached, must be ascertained under state law. The court then undertook an extensive analysis of the relevant North Carolina statutes [3] and cases. It found that the North Carolina law provides as follows: Subcontractors who have not been paid by the general contractor have a direct, independent cause of action against the owner to the extent of any amount due under the general construction contract, and any money owed by the owner under the construction contract must first be used to satisfy subcontractors' claims of which the owner has notice. Moreover, to insure that the owner will receive notice of outstanding subcontractors' claims, the North Carolina statute, N. C. Gen. Stat., 1950, § 44–8, requires the general contractor, before receiving any payment, to furnish the owner with a statement of all sums due subcontractors, and if the general contractor fails to supply the required statement, he is guilty of a misdemeanor. N. C. Gen. Stat., 1950, § 44–12. Finally, the court found further evidence of the direct and independent nature of the subcontractors' claims against the owner in N. C. Gen. Stat., 1950, § 44–9, which provides that should the owner pay the general contractor after receiving notice of a subcontractor's claim, he will nevertheless be liable to the subcontractor to the extent of the amount which was due under the construction contract at the time notice was received.

Based upon these considerations, the Court of Appeals held that, under North Carolina law, the general contractor did not have a property interest in the face amount, as such, of the general construction contract.

[3] N. C. Gen. Stat., 1950, §§ 44–6 to 44–12.

Specifically, the court said that "except to the extent the claim of the general contractor exceeds the aggregate of the claims of the subcontractors, the general contractor has no right which is subject to seizure under the tax lien." *Id.*, at 574. Therefore, concluded the court, since under North Carolina law the taxpayers possessed merely a right to the residue of the fund, and since the Government's tax lien attached to the property interests of the taxpayers as defined by state law, the Government can recover only "so much of the construction price as will remain unpaid after the owners have deducted a sum sufficient to pay the subcontractors." *Id.*, at 575.

The Court of Appeals was correct in asserting that the Government's tax lien attached to the taxpayers' property interests in the fund as defined by North Carolina law. *Acquilino* v. *United States*, — U. S. —, —; [4] *Bess*

[4] This case points up the distinction we drew in *Aquilino*. The facts here show how it simply begs the question to suggest that the principle of the lien-priority cases is somehow subverted or evaded by recognizing that what constitutes the taxpayer's property in the first place is a question of state law. The facts show, too, that it does not promote clarity to substitute, for the property interests created by state law, a rule of federal property law, the main feature of which seems to be an inquiry into what the consequences would be if state law were different from what it in fact is. It is said that we should regard the subcontractor's interest as equivalent to a lien on the general contractor's claim against the owner, overlooking the fact that the law of North Carolina, as interpreted by the Court of Appeals, indicates that there is no such claim. If we are to equate the subcontractor's interest with something it is not, it would be much more appropriate, in terms of similarity, to equate it with the usual mechanic's lien of a subcontractor on the owner's property being improved—which of course is not the general contractor's property, and which could not be taken by the United States under a lien against the general contractor. This only points up the lack of precision and content in the proposed federal definition of property. See also *Fidelity & Deposit Co. of Md.* v. *New York City Housing Auth.*, 241 F. 2d 142 (C. A. 2d Cir.), cited with approval in *Bess* v. *United States*, 357 U. S. 51, 55.

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v. *United States*, 357 U. S. 51, 55; cf. *Morgan* v. *Commissioner*, 309 U. S. 78, 82. It is suggested that the courts of North Carolina have never specifically described the nature of the property rights created by the North Carolina statutes involved in this case, and that the Court of Appeals' interpretation of those statutes is probably incorrect. However, where "the precise issue of state law involved . . . is one which has not been decided by the . . . [state] courts," this Court has said that, "in dealing with issues of state law that enter into judgments of federal courts, we are hesitant to overrule decisions by federal courts skilled in the law of particular states unless their conclusions are shown to be unreasonable." *Propper* v. *Clark*, 337 U. S. 472, 486–487. Since the Court of Appeals is much closer to North Carolina law than we are, and since we cannot say that the court's characterization of the taxpayers' property interests under that law is clearly erroneous or unreasonable,[5] the judgment is

Affirmed.

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[5] See *Sims* v. *United States*, 359 U. S. 108, 114; *Ragan* v. *Merchants Transfer & Warehouse Co.*, 337 U. S. 530, 534; *Estate of Speigel* v. *Commissioner*, 335 U. S. 701, 707–708.

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SUPREME COURT OF THE UNITED STATES

Nos. 1 and 23.—October Term, 1959.

Robert Aquilino and Joseph Spero, d/b/a Home Maintenance Company, and Colonial Sand and Stone Co., Inc., Petitioners, v. United States of America, Ada Bottone, et al.	On Writ of Certiorari to the Court of Appeals of the State of New York.
United States of America, Petitioner, v. Durham Lumber Company, and George H. Carter, Jr.	On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

[June 20, 1960.]

Mr. Justice Harlan, dissenting in Nos. 1 and 23.

I am unable to subscribe to the reasoning which underlies the Court's disposition of these cases. By holding that they both turn on whether the taxpayer had "property" under state law to which the Government's lien could attach, the Court has sanctioned a result consistently prohibited by us in a line of cases dealing with the priority of federal tax liens.[1]

[1] *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47 (1950); *United States* v. *City of New Britain*, 347 U. S. 81 (1954); *United States* v. *Acri*, 348 U. S. 211 (1955); *United States* v. *Liverpool & London Globe Ins. Co., Ltd.*, 348 U. S. 215 (1955); *United States* v. *Scovil*, 348 U. S. 218 (1955); *United States* v. *Colotta*, 350 U. S. 808 (1955); *United States* v. *White Bear Brewing Co.*, 350 U. S. 1010 (1956); *United States* v. *Vorreiter*, 355 U. S. 15 (1957); *United States* v. *Ball Construction Co., Inc.*, 355 U. S. 587 (1958); *United States* v. *Hulley*, 358 U. S. 66 (1958).

In both cases, the delinquent taxpayer is a defaulting general contractor whose subcontractors remain unpaid. The Government's lien is asserted against the chose in action which the general contractor allegedly holds against the owner of the real estate on which the improvements were made, in respect of amounts due from the owner under the construction contract. If the subcontractors had sought to enforce their claims by imposing a lien on that chose in action, there is no question that the Government's lien would prevail. Under the decisions of this Court cited in note 1, *supra*, a federal tax lien asserted against a taxpayer's property under §§ 3670 and 3671 of the Internal Revenue Code of 1939 [2] prevails over all other claims against such property except (1) those which attach and become "choate" before the federal lien attaches, and (2) those specifically protected by § 3672 (a).[3] It is conceded that the interests of the subcontractors in the present cases are not protected by § 3672 (a) and would not be considered choate under the applicable decisions. See *United States* v. *Kings County Iron Works*, 224 F. 2d 232 (C. A. 2d Cir. 1955).

The Court believes, however, that the present cases are different, because under state law, the general contractor in *Aquilino* held his claim against the owner in trust for the subcontractors to the extent of their claims, and because the subcontractors in *Durham Lumber* were given, to the extent of their claims, a direct right of action

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[2] The text of these sections, applicable in the *Aquilino* case, are set forth in note 1 of the Court's opinion in No. 1, *ante*, —. The comparable provisions of the Internal Revenue Code of 1954, §§ 6321 and 6322, applicable in the *Durham Lumber* case, are printed in notes 1 and 2 of the Court's opinion in No. 23, *ante*, —.

[3] That section provides: "Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector . . . ." The comparable provision of the Internal Revenue Code of 1954 is § 6323 (a).

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against the owner in respect of his debt to the general contractor, and that in these circumstances the rights of the subcontractors in the owner's debt are superior to those of the general contractor. It is said that, to the extent of the subcontractors' claims, the general contractor, under state law, thus had no "property" interest in the amounts due him from the owner, and that under the principles enunciated in *United States* v. *Bess*, 357 U. S. 51, a federal tax lien can attach only to a property interest which exists under state law.

I cannot see how it makes any difference, for purposes of the federal tax-lien statute, whether state law purports to prefer subcontractors over the general contractor and parties claiming through him by giving the subcontractors a lien on the general contractor's right of action against the owner or by giving them a prior right to collect the debt itself. In both instances, the owner is under a contractual duty to pay the general contractor and the latter is under a contractual duty to pay the subcontractors. In both instances, the subcontractors are attempting to satisfy their claims against the general contractor. And in both instances, they are seeking to satisfy themselves by claiming precisely the same thing—a prior right in the proceeds of the debt which arises by virtue of the contractual relationship between the owner and the general contractor.[4] In neither instance can the subcontractors

[4] It is noteworthy that the North Carolina law involved in the *Durham Lumber* case requires the general contractor to furnish the owner with a statement of subcontractors' claims "before receiving any part of the *contract price, as it may become due*," and that it is thereafter the duty of the owner to retain an appropriate amount "from the money *then due the contractor*." N. C. Gen. Stat., 1950, § 44–8. (Emphasis added.) Although this section indicates that the general contractor has no right to collect the proceeds of the main contract until the statutory conditions are satisfied, it obviously recognizes the owner's contractual obligation as the real basis of the

collect more than that to which the subcontract entitles them, and in neither can the owner be required to pay more than that to which the main contract obligates him. If federal law requires that subordination of the general contractor's interest be ignored in the one instance, it does so equally in the other.

The *Bess* case does not require a contrary conclusion. That case held only that while a federal tax lien attached to the cash surrender value of a life insurance policy owned by the taxpayer, it did not attach to the proceeds paid on his death, because under state law he had no right to such proceeds during his life. There was no reason under those circumstances why state property concepts should not control. To read that case as standing for the proposition that such concepts must also be controlling in cases such as these defeats the rule that "the relative priority of the lien of the United States for unpaid taxes is . . . always a federal question to be determined finally by the federal courts." *United States* v. *Acri*, 348 U. S. 211, 213. It is one thing to say, as the Court did in *Bess*, that the federal interest in uniform application of federal tax liens does not require, as a general rule, that state property concepts be disregarded. It is quite another to permit such concepts to control the extent of a federal lien's application in situations indistinguishable from those where the Court has in fact, rightly or wrongly, enforced a uniform federal rule. Given federal supremacy in this field, it surely cannot be that the federal courts may not appraise for themselves the true impact of state-created rights upon the priority of federal tax liens within the criteria established by this Court. Cf. *Carpenter* v. *Shaw*, 280 U. S. 363, 367; *City*

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transaction and the source of the subcontractors' rights. The subcontractors' claims are thus not akin to liens on the owner's real estate, as this Court suggests, but are asserted solely in respect of the monetary claim held by the general contractor against the owner.

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of Detroit v. *Murray Corporation*, 355 U. S. 489, 492. To recognize the substantial equivalence of the situations is not to create a new rule of federal property law but to require an evenhanded application of an already established one. It seems to me that Judge Fuld of the New York Court of Appeals was quite right in holding in the *Aquilino* case that New York could not, consistently with the past decisions of our Court, defeat the otherwise superior federal lien upon the owner's debt to the general contractor by converting the debt into a trust for the benefit of the subcontractor.[5]

To read *Bess* as the Court does can only lead to confusion in the administration of the federal tax-lien statute. A taxpayer's property in a debt is surely diminished by the imposition of a lien on his interest, for he has no right to collect the liened portion nor to alienate it. Yet in precisely this situation, we have held that the federal tax lien is not affected by such diminution. *United States* v. *Liverpool & London Globe Ins. Co., Ltd.*, 348 U. S. 215. If this holding is to be preserved after today's decision, subsequent cases must turn on the elusive distinction between diminishing a greater property interest and

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[5] "It is, by now, exceedingly well settled that no state-created rule may defeat the paramount right of the United States to levy and collect taxes uniformly throughout the land. (See United States v. Vorreiter, 355 U. S. 15, revg. 134 Col. 543; United States v. White Bear Brewing Co., 350 U. S. 1010, revg. 227 F. 2d 359; United States v. Colotta, supra, 350 U. S. 808, revg. 224 Miss. 33; United States v. Scovil, supra, 348 U. S. 218, 220-221; United States v. New Britain, supra, 347 U. S. 81, 84-87; United States v. Kings County Iron Works, supra, 224 F. 2d 232, 237). That being so, it follows that the provision in this state's Lien Law, to which respondents point—that funds received by a contractor from the owner for the improvement of real property shall be deemed 'trust funds' for the payment of subcontractors (§ 36-a; § 13, subd. [7])—may not be construed to affect the rights of the government or the priority of its tax lien." 3 N. Y. 2d, at 516, 146 N. E. 2d, at 777-778.

initially conferring a lesser one.[6] The very difficulty which this Court experiences in trying to determine whether under New York law the general contractor really holds only a bare legal title in trust for the subcontractors or has full ownership of the debt subject to a lien in favor of the subcontractors demonstrates the futility of attempting to draw such distinctions for federal purposes. I venture to suggest that on remand, the Court of Appeals can with equal facility label the subcontractors' interests "property" or a "lien," the relevant incidents of the relationship being the same in either case. Why should not that court, and the legislatures of other States readily respond in choosing the former alternative?

I would affirm the judgment in No. 1, and would reverse in No. 23 on the ground that North Carolina can under no circumstances accord subcontractors a right in the proceeds of the debt arising from the construction contract superior to the Government's lien without satisfying one of the two requirements laid down by federal law. If the

[6] It will not do to distinguish the present type of case from the lien-priority cases on the ground that in the latter cases the taxpayer remains the owner in a very real sense and can continue to enjoy the property if he discharges the debt it secures. In both instances, the taxpayer is temporarily deprived of certain incidents of ownership as a device for securing the payment of a debt, and is restored to the full enjoyment of the property only when the debt is discharged. And it is illusory to say that ownership of a debt which can be neither collected nor alienated is any more "real" than the ownership of no debt at all. Whether the diminution of the taxpayer's interest is sufficiently definite and complete to conclude the federal lien is precisely the question on which this Court has held federal law must control. It is admitted that, if the federal standard of "choateness" developed by this Court in the lien-priority cases is applied, the incidents of ownership retained by the taxpayers here must in fact be deemed greater than those retained by taxpayers in cases where state-created liens imposed on their interests have prevailed over the Government's lien.

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federal standard of choateness is thought to be an undesirable restriction on the States' freedom to regulate property relationships, the cases establishing that standard should be expressly overruled and not emasculated by dubious distinctions.

MR. JUSTICE BLACK, while adhering to the dissenting views expressed by him in *Commissioner* v. *Stern*, 357 U. S. 39, 47, and *United States* v. *Bess*, 357 U. S. 51, 59, concurs in this opinion.